TAX NEWS

WINTER 2016

TAKING ADVANTAGE OF

Last Minute Tax Deductions

There is still an opportunity to lower your tax liability before the year ends. This can be accomplished in a few different ways as follows:

1. **Charitable Contributions:** If you are electing to itemize your allowable itemized deductions on Schedule A of your 2016 federal income tax return, then charitable donations are an excellent way to accomplish this goal. Whether the contribution is in the form of checks written and deposited into the U.S. Postal Box *before* midnight on December 31, 2016, or made online with a credit card or direct transfer from a bank account, your tax bill can decrease based on your individual marginal tax bracket. For example, if your bracket is at 25% then you will save 25 cents on each dollar contributed.

   When you do make charitable contributions make sure that you have received a written acknowledgment from the charitable organization which specifies that they are a Section 501(c)(3) organization, the amount of your contribution, and language which specifies that you have not received any goods or services in exchange for your donation. If you have received any goods or services in exchange then the amount must be specified on the acknowledgment and the net charitable contribution is the amount which will be allowed to be deducted.

   If a check is written or a credit card is used, then the taxpayer must have a written acknowledgment for each individual contribution which is *greater than* **$249**. The law requires that the taxpayer "may deduct a charitable contribution if the taxpayer substantiates the deduction with a contemporaneous written acknowledgment of the contribution by the donee organization." The important item here is that the taxpayer must have this document in their possession by the *earlier of* the time that the return is filed or the due date of the tax return including extensions. The original due date of the return is April 15 therefore, if the taxpayer files the return on March 27 then that is the day on which they must have the document in their possession. If the IRS audits the return then the taxpayer must be able to prove the day that the document was received. If the document is not in their possession then the return needs to be extended so that it can be received and considered contemporaneous.

2. **Noncash Charitable Contributions:** There are charitable contribution deductions allowed for property which is donated to qualifying charities and the rules are specific based on dollar amounts attributed to those donations. The contribution is allowable *only if* the taxpayer satisfies substantiation requirements.

   The law provides that there are separate requirements for all contributions of property with a claimed value of $250 or more, contributions of property with a claimed value exceeding $500, and contributions of property with a claimed value *exceeding* $5,000.

   The rules state that for contributions exceeding $5,000, "similar items of property" are aggregated for purposes of the substantiation rules. The term "similar items of property" is defined to mean "property of the same generic category or type," such as clothing, jewelry, furniture, electronic equipment, household appliances, or kitchenware.

   Again the rules state that an individual may deduct a gift of $250 or more only if he substantiates the deduction with "a contemporaneous written acknowledgment of the contribution by the donee organization." The law provides that this acknowledgment must include a description of any property other than cash contributed.

   For noncash contributions *in excess of* $500, taxpayers are required to maintain written records with respect to *each* item of donated property that include, among other things:

continued on page 2

Dear Client:

We are near the end of 2016 and we want you to be aware of some of the things that have happened in the tax world during the year and items of consideration that you may want to address before 2016 comes to a close.

Some of these items may not directly impact your present tax situation, but could in the future. I encourage you to read the articles presented and ask that you share them with your friends, neighbors, etc. and contact me with any questions that you might have on these and any other tax issues.

IRA and Pension Opportunities

As an individual you can *exclude* the increase in the value of an investment when you make a contribution into a Roth IRA. The contribution amount is not deductible but the growth is never taxed. The earlier you begin investing in a Roth IRA the sooner you receive the benefit of tax-free growth. Your maximum contribution amount for 2016 is $5,500 and an additional $1,000 is permitted if you have reached age 50 or above during 2016. The contribution is based on your filing status and modified adjusted gross income. For 2016 a single taxpayer can have a modified adjusted gross income amount of $117,000 and below and be permitted to contribute the full amount of up to $5,500 and additional $1,000. As the $117,000 amount increases the contribution amount is phased out allowing a partial contribution. When the modified adjusted gross income reaches $132,000 the ability to contribute to a Roth IRA is completely gone.

For a married couple filing a joint return the law allows a contribution for *each* spouse of $5,500 and $1,000 for the 50 or older contribution. The couple with a modified adjusted gross income of $184,000 and below can maximize the contribution and there is a phase-out as the modified adjusted gross income reaches $194,000.

If the dollar thresholds are an issue then the taxpayer can achieve the second goal in tax which is "deferral" of the tax into a future tax year when it may be more beneficial to pay the tax because the tax bracket may be lower or other transactions may be taking place which will allow better planning opportunities.

A contribution to a nondeductible IRA allows the growth in the investment to be "deferred" into the future tax period. In addition, opportunities can arise in the future when your income decreases and you fall into a lower bracket you could "convert" the nondeductible IRA into a Roth IRA and pay less tax in the year of conversion on the growth or perhaps no tax if your income has really dipped in a particular year or years. The *conversion* can be done in pieces and is not an all or nothing approach. The best part about a nondeductible contribution to an IRA is that your modified AGI is not a factor. So if you are in a 10% or 39.6% bracket and even already have an employer sponsored pension plan you can still make a contribution to the IRA and look to future opportunities to save on taxes.

Mortgage Interest Deduction

Another item which can help reduce your tax liability before the year ends is to make your January 2017 mortgage payment before December 31, 2016 so that the mortgage company can credit your account for the payment in 2016. You are a cash basis taxpayer so you will receive the extra credit in the year paid.

When you do start taking distributions on your IRA you will only have some of it taxed and some will be a tax-free return of your investment.

In addition, don't forget about checking with your employer to see if you can contribute any more into your employer-sponsored §401(k) plan, §403(b) plan or §457(b) plan before the year ends. These plans allow tax deferral and permit tax savings in the current year with the growth deferred into another period when distributions are received.

For issues and questions dealing with a Roth IRA, nondeductible IRA and employer sponsored plans give me a call for more details.

Last Minute Deductions *continued from page 1*

a. the approximate date the property was acquired and the manner of its acquisition;
b. a description of the property in detail reasonable under the circumstances;
c. the cost or other basis of the property;
d. the fair market value (FMV) of the property at the time it was contributed; and
e. the method used in determining its FMV.

One rule states that no deduction is allowed for contributions of clothing or "household items" unless such items are "in good used condition or better." The rule defines the term "household items" to include furniture, furnishings, electronics, appliances, linens and other similar items.

Of major importance are the rules for contributions of property valued *in excess of* **$5,000**. Here the taxpayer must generally satisfy the substantiation requirements discussed above and must also obtain a "qualified appraisal" of the items and attach, to their tax return, a fully completed appraisal summary.

The law provides that a "qualified appraisal" must be performed by someone recognized and designated as a "qualified appraiser" by the IRS.

This issue of noncash items *greater than* **$5,000** is very serious because there are times when a large amount of a home's contents are being disposed of because of a lifestyle change such as the death of a spouse or parent and the property is not going to be used by the survivors of the decedent. Sometimes the large disposition of property is when there is a relocation from the family home because of a job change, divorce, down-sizing because of empty nest or retirement. The IRS has challenged several large contributions over the past four to five years which have been major Tax Court cases finding in favor of the government because the strict substantiation rules have not been followed by the taxpayers.

The important issue here is that the *greater than* $5,000 substantiation and appraisal rule is a cumulative rule. Therefore, if the taxpayer had several noncash contributions during the calendar year then an appraisal would still be needed. It is not just one specific contribution. As an example if you gave away clothing in January, March, July and December and each one was $1,500, you would need your acknowledgment because each one was *greater than* $249 and you would have to report the details of each of the contributions on IRS Form 8283 but because the cumulative amount was $6,000 (4 times $1,500) you still need to meet the appraisal requirement.

If you would like to discuss these rules on charitable contributions please contact me.

Health Insurance Coverage Issues

As you know by now, the Affordable Care Act of 2010 is now in full swing and under the general rule every American is required to have medical insurance coverage which satisfies the rules under what is defined as "essential minimum coverage." In summary, "essential minimum coverage" means that the policy has no annual or lifetime coverage caps; cannot deny coverage because of a pre-existing condition, provides access to the emergency room, allows for an annual physical and assessment of the insured's health status, allows for testing for breast cancer, ovarian cancer, etc. and allows for a colonoscopy.

The most important issues about these coverages and mandates is that reporting about your coverage is required on your federal income tax return each year. If a taxpayer has coverage through one of the State Exchanges or the Federal Marketplace then they are required to be issued an IRS Form 1095-A "Health Insurance Marketplace Statement" from the agency through which they obtained the coverage. The rule states that the taxpayer is to receive the form *no later than* January 31, 2017 for the 2016 coverage year. Note, however, that the IRS has recently extended the due date for the Forms 1095-B and 1095-C until March 2, 2017 so you may receive the forms after January 31st. If you obtained your 2016 coverage through the State Exchange or Federal Marketplace then please make sure that you give me a copy of the Form 1095-A when you present your 2016 tax information to me for preparation of your 2016 tax return.

The Form 1095-A will provide the needed information to determine if you are eligible for any premium tax credit, if you received any advanced premium tax credit and who in your household was covered under this policy. The information will also determine if you will be eligible to receive additional premium tax credits or if you must repay some or all of the advanced premium tax credits that you received in each month that you obtained coverage through the State Exchange or Federal Marketplace.

If you have individual coverage through a private insurance policy purchased on the open market or under a government sponsored plan during 2016 then you should be receiving an IRS Form 1095-B titled "Health Coverage" *no later than* March 2, 2017. You will need to include a copy of this document to me for use in preparing your 2016 income tax return. This will be issued to you by your insurance carrier, government sponsored plan or could also be issued by the group plan administrator if the coverage is under an employer's plan. This document is important because it will report the months that your plan met the requirements of minimum essential coverage and everyone in your household who was covered. As a result of this coverage you will not be subject to the "individual shared responsibility payment" (penalty) assessed for not being covered. This penalty is the *greater of* $695 for up to 3 individuals in your household who are 18 and older or 2½% of your adjusted gross income *over* the required threshold for filing your return. If you would like to discuss this further please contact me for this and other issues related to health insurance and medical deductions.

There is another IRS form that could possibly be sent to you which is IRS Form 1095-C "Employer-Provided Health Insurance Offer and Coverage." You could receive this document because you work for an employer who employs 50 or more full-time employees. The form is used to report information about whether the employer made an offer to you for minimum essential coverage for 2016 and whether or not the coverage offered, had value which pays *at least* 60% of the claims under the coverage and whether it is affordable coverage to you. In addition, if your employer had 50 or more full-time employees and did not offer coverage then the employer also will be required to provide you with a Form 1095-C if no offer of coverage was made. This form will also be required to be issued to you *no later than* March 2, 2017. Please provide a copy to me when it is time to prepare your 2016 income tax return. If you would like to discuss any issues concerning health insurance coverage requirements as it pertains to your tax issues please contact me.

Education Credits and Deductions

If you, your spouse and/or your dependents have tuition or fees due for the January 2017 school year then paying them before the end of the year could increase the amount of credit or deductions in 2016. Most educational institutions require the payments prior to the end of the year so it is most likely that this will be done already. However, if you are thinking about deferring that payment into January of 2017 then maybe we need to discuss the tax issues that may impact you. Please call me with any questions.

Education Credits and Tuition and Fees Reporting Issues

In late December 2015, Congress passed tax legislation called the PATH Act (Protecting Americans from Tax Hikes). One of the provisions in this legislation requires that the educational institutions must issue the IRS Form 1098-T which must report the actual Tuition and Fees *paid to* the institution during the tax year. Prior to this legislation, the institution could report the amounts *billed for* tuition and fees. There were times when the actual amounts *paid* in a tax year were not the same as the amounts *billed* for that tax year. The institutions may no longer choose which amounts to report on the Form 1098-T as under prior law. In a recent announcement, the educational institutions were given some relief by the IRS, and the amount billed may still be reported instead of the amount paid on the 2016 Form 1098-T. In addition, taxpayers must report the institution's Employer Identification Number (EIN) on the tax return in order to receive an American Opportunity Credit or a Deduction for Tuition and Fees.

The PATH Act also requires that I must do additional due diligence in determining eligibility for your education credits and deductions so I will ask that you submit a copy of the Form 1098-T to me when you give me your tax data for 2016. If you have any questions about the opportunity for receiving education credits or deductions please contact me.

Life Style Changes and Events

Life events such as marriage, divorce, death of a spouse, birth or adoption of a child, a new job or the loss of a job and retirement, all impact year-end tax planning.

Marriage: Marital status (single, married or divorced) for the entire tax year is determined on December 31st. Because the income tax brackets vary depending upon filing status, a marriage penalty or a marriage benefit may result for any particular couple.

As a general rule, if each partner has income approximately in the same amount as the other, they will pay more filing as a married joint return than as two single individuals. Accelerating or postponing marriage or divorce at year-end might be considered based upon this difference in tax brackets.

Same-Sex Marriage: The Supreme Court held in June 2015 that the Fourteenth Amendment requires a state to license a marriage between two people of the same sex. States must recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-state.

Co-habitation: If there is a couple who owns a principal residence together and they are not married then there is good news now as a result of a Tax Court case in 2015 and an affirmation in the Ninth Circuit Court of Appeals to which the IRS has acquiesced in 2016. Now when multiple unmarried taxpayers co-own a qualifying residence, the debt limits of $1.1 million for acquisition debt apply to each individual. Therefore, if two people were thinking of getting married and the debt is *greater than* $1.1 million then they may want to stay single and continue to live together unmarried.

Dependents: A child born at any time during the tax year is considered a child for that entire tax year. Subject to Adjusted Gross Income (AGI) limits, a child born at year-end 2016 entitles the parent to a full $4,050 personal exemption, a full $1,000 child tax credit and up to a $600 child care credit if eligible.

These benefits also have cut-off ages that is tied to the age of the dependent before the close of the tax year: if under age 19 (or incapacitated, or under 24 if a student) the dependency exemption could be lost. Also remember if the child is no longer a full-time student for any part of 5 months they will not qualify as your dependent. If under age 17 you can use the child *tax* credit. If under age 13 (or incapacitated) you can use the child *care* credit.

Retirement: Taxpayers may want to take a look at a number of different provisions at year-end in anticipation of retirement, at the point of retirement, or after retirement. Many of these provisions have opportunities and deadlines keyed to the tax year. Three strategies especially stand out for year-end consideration:

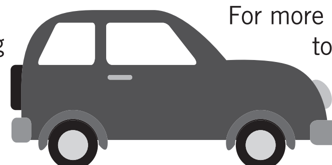
- *Minimum distribution requirements (RMD).* Most retirement arrangements (other than Roth IRAs) require that participants begin to take annual payments of benefits in the year they turn age 70½. While distributions generally must be made at the end of the calendar year, distributions for the first year can be delayed until April 1 after they turn 70½.
- If you do have an IRA and have a RMD then you may want to consider a qualified distribution to a charitable organization which will allow a direct distribution to the charity and the distribution will not be included in your gross income under the rules of what is known as a Qualified Charitable Distribution (QCD). In addition, each taxpayer can have up to $100,000 directly distributed annually from the IRA to the qualified charity. For more information on a QCD and other life style changing events please contact me right away before the year ends.

Contact the office if you have any questions regarding the issues addressed here or any other tax events that may affect your 2016 tax liability.

Automobile Used for Business Purposes

If you use your automobile for business then you are required to keep a log of your business miles if you want to be able to deduct the expenses incurred to operate the vehicle. There are two separate methods allowed under the law for business use of an automobile. The first method is the standard mileage rate which is adjusted annually based on the overall operating expense studies done by the IRS which takes into consideration the costs of maintenance, repairs, depreciation, registration, gasoline prices, etc. The standard mileage rate for operating a vehicle for business purposes in 2016 is 54 cents per business mile. When your vehicle use is reported on your tax return you are required to report the total miles driven during the year, the total commuting miles and total business miles.

The second method of reporting business use of a vehicle is the actual method. This method requires that the taxpayer not only maintain a log of total miles, business miles and commuting miles but also report the details of the actual cost of operating the vehicle. These costs include repairs, maintenance, gasoline, oil, registration, insurance, inspections, car washes, etc. These actual costs of operating expenses are allowed as an ordinary and necessary business expense deduction to the extent of the ratio of business miles driven during the tax year to the total miles driven during the year. This ratio is also used to determine the annual amount of cost recovery or depreciation allowed on the cost or adjusted basis of the vehicle placed in service. Normally, passenger vehicles used in business are referred to as luxury automobiles and have an annual cost recovery deduction which limits the amount of depreciation which is allowed.



For more important information on this topic and any other issues dealing with autos please contact me right away. I am here to service your tax needs.